Case Study of Various Financial and Managerial Accounting Issues

By
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Abstract

This thesis is different from the traditional thesis done for the Honors College. This thesis took place over the course of 2 semesters of classes in Accounting 420. Dr. Vicki Dickinson led this class and helped shape our professional development in the field of accounting. The cases were not the only part of the thesis. Every other week of the class an accounting firm would come visit. They would have a slideshow and guest speaker and discuss accounting related topics that were relevant to the field. Afterwards there was always an opportunity to network with the professionals. There were also two other case studies that each student had to participate in. These case studies were done in a randomized group. These case studies were put on by PWC and KPMG. We all had to speak in front of partners the findings that we came up with that would best help the company we were assigned. This class not only helped my professional development, but also helped boost my recruiting and knowledge in accounting. Being able to meet with the professionals in a relaxed setting was extremely beneficial. All of these cases in some way, shape, or form required an in-depth analysis into a company's financial statements. The Cases discussed in my thesis are all relevant to major accounting issues. Most of them are pertaining to accounting methods and the differences it has on financial statements. A major benefit of this thesis is getting the ability to look at different industries. I was able to see oil and gas companies all the way to technology companies. This wide variety of clients is hard to find in the professional world because everyone is specialized. This insight will give me a head start for my career as an accountant.

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Case 1

Executive Summary: Glenwood Heating Inc.

Glenwood Heating Inc. is a company that specializes in creating heaters that are revolutionary to the market. Glenwood is not a very large company because they have to rent equipment on a yearly basis. This poses a problem because the rental agreements can change year to year. They have a shortage of cash with only $426 on hand, but their receivables are $99,400. Glenwood may have a hard time gathering all their money because of their limited resources. Glenwood has an outstanding debt of $380,000 that it has to pay over the next 20 years so that is something to think about before investing in the company. Glenwood's total assets are at $642,632 which is a respectable number, but again a little smaller than most companies. Their total interactions over the whole year were just shy of $1 million which is not bad at all considering that their total liabilities are only $413,090. Glenwood Inc. is not a bad investment, but is a little risky this past year they procured $92,742 of Net income. Their net income is not that large, but definitely shows that the company is promising.

Glenwood Heating Inc.

Income Statement

Sales	$398,500
CGS	$(177,000)
Gross Margin	$221,500.00
Operating Exp.	
Misc.	$(34,200)
BDE	$(994)
Depr.- Building	$(10,000)
Depr.- Equipment	$(9,000)
Rent Expense	$(16,000)
Interest Expense	$(27,650)
Total Operating Exp.	$(97,844)
Operating Income	$123,656
Income Tax	$(30,914)
NET Income	$92,742

Glenwood Heating Inc.

Statement of Retained Earnings

Beginning Retained Earnings	$313,450
Add: Net Income	$92,742
	$406,192
Less: Dividends	$(23,200)
Ending Retained Earnings	$382,992

Glenwood Heating Inc.

Trial Balance-Part A

	Debits	Credits
Cash	$426	
A/R	$99,400	
Allowance for bad debts		$994
Inventory	$62,800	
Land	$70,000	
Building	$350,000	
Accumulated Depr- Building		$10,000
Equipment	$80,000	
Accumulated Depr- Equipment		$9,000
A/P		$26,440
N/P		$380,000
Int/P		$6,650
Commons Stock		$160,000
Dividend	$23,200	
Sales		$398,500
Cost of Goods Sold	$177,000	
Operating Expenses	$34,200	
Bad Debt Expense	$994	
Depreciation Expense- building	$10,000	
Depreciation Expense- Equipment	$9,000	
Rent expense	$16,000	
Interest Expense	$27,650	
Provision for income tax	$30,914	
Total	**$991,584**	**$991,584**

Glenwood Heating Chart of Accounts Part B:

Part B: Recording Additional Information						
				Assets		
Transactions	Cash	Recievable	Allowance For Bad Debts	Inventory	Land	Building
Balances Part A	$ 47,340.00	$ 99,400.00		$ 239,800.00	$ 70,000.00	$ 350,000.00
Part B (1) Bad Debts			$ 994.00			
Part B (2) COGS				$ (177,000.00)		
Part B (3) Depreciation						
Building						
Equipment						
Part B (4) Equipment						
Rental Payment	$ (16,000.00)					
Part B (5) Incomt Tax	$ (30,914.00)					
Balances	**$ 426.00**	**$ 99,400.00**	**$ 994.00**	**$ 62,800.00**	**$ 70,000.00**	**$ 350,000.00**

			=	Liabilities	+	Stockholders'	Equity
Accum. Depr. Building	Equipment	Accum. Depr. Equipment	Accounts Payable	Note Payable	Interest Payable	Common Stock	Retained Earnings
	$ 80,000.00		$ 26,440.00	$ 380,000.00	$ 6,650.00	$ 160,000.00	$ 313,450.00
							$ (994.00)
							$ (177,000.00)
$ 10,000.00							$ (10,000.00)
		$ 9,000.00					$ (9,000.00)
							$ (16,000.00)
							$ (30,914.00)
$ 10,000.00	**$ 80,000.00**	**$ 9,000.00**	**$ 26,440.00**	**$ 380,000.00**	**$ 6,650.00**	**$ 160,000.00**	**$ 69,542.00**

Glenwood Heating Inc.

Balance Sheet

Assets	
Current Assets	
Cash	$426
Accounts Receivable	$99,400
Inventory	$62,800
Allowance for Doubtful Accounts	$(994)
Total Current Assets	$161,632
Long-term Assets	
Land	$70,000
Building	$350,000
Accumulated Depr.- Building	$(10,000)
Equipment	$80,000
Accumulated Depr.- Equipment	$(9,000)
Total Assets	**$642,632**
=	
Liabilities	
Current Liabilities	
Accounts Payable	$26,440
Long-term Liabilities	
Notes Payable	$380,000

Interest Payable	$6,650
Total Liabilities	$413,090
+	
Stockholders' Equity	
Common Stock	$160,000
Retained Earnings	$69,542
Total Liabilities and Stockholders' Equity	**$642,632**

Home Heaters

Trial Balance-Part A

	Debits	Credits
Cash	$47,340	
A/R	$99,400	
Inventory	$239,800	
Land	$70,000	
Building	$350,000	
Equipment	$80,000	
A/P		$26,440
N/P		$380,000
Int/P		$6,650
Commons Stock		$160,000
Dividend	$23,200	
Sales		$398,500
Operating Expenses	$34,200	
Interest Expense	$27,650	
Total	**$971,590**	**$971,590**

Both Heating Companies Chart of Accounts Part A:

Home Heaters					
Part A: Recording Basic Transactions					
		Assets			
	Cash	Recievable	Inventory	Land	Building
1	$ 160,000.00				
2	$ 400,000.00				
3	$ (420,000.00)			$ 70,000.00	$ 350,000.00
4	$ (80,000.00)				
5			$ 239,800.00		
6		$ 398,500.00			
7	$ 299,100.00	$ (299,100.00)			
8	$ (213,360.00)				
9	$ (41,000.00)				
10	$ (34,200.00)				
11	$ (23,200.00)				
12					
Balances	**$ 47,340.00**	**$ 99,400.00**	**$ 239,800.00**	**$ 70,000.00**	**$ 350,000.00**

	=	**Liabilities**		+	**Stockholders**
Equipment	Accounts Payable	Note Payable	Interest Payable	Common Stock	Retained Earnings
				$ 160,000.00	
		$ 400,000.00			
$ 80,000.00					
	$ 239,800.00				
					$ 398,500.00
	$ (213,360.00)				
		$ (20,000.00)			$ (21,000.00)
					$ (34,200.00)
					$ (23,200.00)
			$ 6,650.00		$ (6,650.00)
$ 80,000.00	**$ 26,440.00**	**$ 380,000.00**	**$ 6,650.00**	**$ 160,000.00**	**$ 313,450.00**

Executive Summary: Eads Heaters, Inc.

Eads Heaters, Inc. sells heaters for home and industrial purposes. Eads had an active past year with transactions. The company has a current ratio of 2.13 which is well above a 1 making Eads more than capable of covering any current liabilities it may have. The reason that this company has such a good current ratio is because they lease equipment and have to be ready to pay the lease in good time. Their current cash on hand is at a whopping $7,835 a respectable sum of money to have on hand. They have total assets of $703,765 giving them a bit of an edge of Glenwood. Both companies pay out the same amount of dividends for all 160,000 shares of Common Stock. That is not that large of a dividend payment, but shareholders cannot complain because they are getting something. What is worrisome is Net Income. Their net income is only $70,515 making it fall behind Glenwood, but their interactions on the trail balance are over $1.1 million which is very respectable. Eads is the safer investment because of its 8-year lease due to the fact that it will have the equipment for that long and is able to pay off its liabilities much quicker.

Eads Heaters Inc.

Income Statement

Sales	$398,500
CGS	$(188,800)
Gross Margin	$209,700
Operating Expenses	
Misc.	$(34,200)
BDE	$(4,970)
Depr.- Building	$(10,000)
Depr.- Equipment	$(20,000)
Depr.- Lease	$(11,500)
Interest Expense	$(35,010)
Total Operating Expenses	$(115,680)
Income from Operations	$94,020
Income Tax	$(23,505)
NET Income	$70,515

Eads Heaters Inc.

Statement of Retained Earnings

Beginning Retained Earnings	$313,450
Add: Net Income	$70,515
	$383,965
Less: Dividends	$(23,200)
Ending Retained Earnings	$360,765

Eads Heaters, Inc.

Trial Balance-Part B

	Debits	**Credits**
Cash	$7,835	
A/R	$99,400	
Allowance for Bad Debts		$4,970
Inventory	$51,000	
Land	$70,000	
Building	$350,000	
Accum Depr. Building		$10,000
Equipment	$80,000	
Accum Depr. Equipment		$20,000
Leased equipment	$92,000	
Accum Depr. Leased		$11,500
A/P		$26,440
N/P		$380,000
Int/P		$6,650
Lease Payable		$83,360
Commons Stock		$160,000
Dividend	$23,200	
Sales		$398,500
Cost of Goods Sold	$188,800	
Operating Expenses	$34,200	
Bad Debt Expense	$4,970	
Depreciation Expense- Building	$10,000	
Depreciation Expense- Equipment	$20,000	
Depreciation Expense- Leased Equipment	$11,500	
Interest Expense	$35,010	
Provision for Income Tax	$23,505	
Total	**$1,101,420**	**$1,101,420**

Eads Heaters Chart of Accounts Part B:

Part B: Recording Additional Information						
				Assets		
Transactions	Cash	Recievable	Allowance For Bad Debts	Inventory	Land	Building
Balances Part A	$ 47,340.00	$ 99,400.00		$ 239,800.00	$ 70,000.00	$ 350,000.00
Part B (1) Bad Debts			$ 4,970.00			
Part B (2) COGS				$ (188,800.00)		
Part B (3) Depreciation						
Building						
Equipment						
Part B (4) Equipment						
Lease						
Lease Payment	$ (16,000.00)					
Depreciation						
Part B (5) Incomt Tax	$ (23,505.00)					
Balances	**$ 7,835.00**	**$ 99,400.00**	**$ 4,970.00**	**$ 51,000.00**	**$ 70,000.00**	**$ 350,000.00**

					=	Liabilities		+	Stockholders'	Equity
Accum. Depr. Building	Equipment	Accum. Depr. Equipment	Leased Equipment	Accum. Depr. Lease	Accounts Payable	Note Payable	Lease Payable	Interest Payable	Common Stock	Retained Earnings
	$ 80,000.00				$ 26,440.00	$ 380,000.00		$ 6,650.00	$ 160,000.00	$ 313,450.00
										$ (4,970.00)
										$ (188,800.00)
$ 10,000.00										$ (10,000.00)
		$ 20,000.00								$ (20,000.00)
			$ 92,000.00				$ 92,000.00			
							$ (8,640.00)			$ (7,360.00)
				$ 11,500.00						$ (11,500.00)
										$ (23,505.00)
$ 10,000.00	**$ 80,000.00**	**$ 20,000.00**	**$ 92,000.00**	**$ 11,500.00**	**$ 26,440.00**	**$ 380,000.00**	**$ 83,360.00**	**$ 6,650.00**	**$ 160,000.00**	**$ 47,315.00**

Eads Heating Inc.

Balance Sheet

Assets	
Current Assets	
Cash	$7,835
Accounts Receivable	$99,400
Inventory	$51,000
Allowance for Doubtful Accounts	$(4,970)
Leased Equipment	$92,000
Accumulated Depr.- Lease	$(11,500)
Total Current Assets	$233,765
Long-term Assets	
Land	$70,000
Building	$350,000
Accumulated Depr.- Building	$(10,000)
Equipment	$80,000
Accumulated Depr.- Equipment	$(20,000)
Total Assets	**$703,765**
=	
Liabilities	
Current Liabilities	
Accounts Payable	$26,440
Lease Payable	$83,360
Long-term Liabilities	
Notes Payable	$380,000
Interest Payable	$6,650
Total Liabilities	$496,450
+	
Stockholders' Equity	
Common Stock	$160,000

Retained Earnings	$47,315
Total Liabilities and Stockholders' Equity	**$703,765**

Case 1 Conclusion

In this case I am not going to lie I felt overwhelmed when I first started going through the instructions. I had already taken Accy 310 which I thought had given me the groundwork needed to be fluent in Excel, but there is obviously still much for me to learn. While working on the case I realized that if I was not sure of something working it out multiple ways and with my group was the best thing possible to do. I assured my knowledge in FIFO and LIFO and was pleasantly surprised as to how well most of the actual accounting went. Doing the adjustments was easy and I feel like I learned a lot of that because that is exactly what we were doing in intermediate at the time. The problem I ran into was with the lease. I payed attention in class, but was having trouble finding the right answer, but eventually we succeeded.

Creating all of the Financial statements required for the companies gave us insight into their records. Our first task we created a document which had all of the companies' transactions for the fiscal year. In the next task, we created a trail balance for each company to make sure that we had journalized everything correctly the trail balance was used as an error check. Finally, we created the income statements, statements of retained earnings, and the balance sheet. Our numbers checked out with all of the correct balances making this case a success. Creating all of these documents from scratch allowed us to get a good insight into what company is a better investment. Eads company is a better investment because in the long run it seems they will run into less problems, but also, they have no problems covering any liabilities that may occur throughout their business process.

Case 2

The following numbered list contains the answers to the required questions from our analysis of the financial statements and operations of Molson Coors Brewing Company.

A. Sales, Cost of goods sold, Gross profit are the first third of the income statement these are used to help calculate the revenue that has been generated from the cost of the product and how much it sold for. The next section is the operating expenses. It is broken up into selling and administrative to show a more detailed description of the flow of costs. The operating expenses are taken from the gross profit to give the company their Income after operations. This allows the company to be more efficient on being able to see how each cost effects their revenue individually. Interest expense is then taken out of the income and then what is left is income before taxes. Taxes are taken out and the company now has their net income. Earnings per share is just the common stock shares outstanding and is used to see how much income is gained per share

B. Large companies are broken up into different sectors and divisions which is why that the classified income statement is necessary. It breaks down each individual operation and allows the company to see their stance on the single operation instead of all operations as a whole.

C. Persistent income is just the income or earnings that are consistent throughout the accounting periods of a company. This could also be used by investors to project dividend payments or stock splits, but is mainly used to give stockholders a basis of where the company is standing currently compared to its past records.

D. Comprehensive income is net income with additions added or subtracted to it that were not shown on the income statement because the items have not yet been realized yet. Net income does not account for these items because they could be extraordinary items that would affect the companies' net income in a way that would be unnatural or cause serious increase or decrease which could deflate or inflate the companies' current net income

E. Sales is the number of units sold multiplied by the selling price stated for each unit. This does not include taxes or expenses. Net sales is sales after any taxes have been taken out of it. These taxes are a government imposed tax on beer shipments. The reason these are important is because it can show the exact amount of actual sales and then allows a company to look into the taxes and see how much is taken out.

F. Special Items consist of

a. Infrequent or unusual items

b. Impaired or asset abandonment losses

c. Restructuring charges and other employee related costs

d. Fees of termination of significant operating agreements and gains (losses) on disposal of investments

e. I disagree with the company placing all of the items as operating expenses. Infrequent items should be extraordinary items and not grouped into a regular operating expense, but I think restructuring charges should be an operating expense because to restructure something would require hands on operations to make everything go smoothly. The items are placed separately to show that the items are not part of the day to day tasks and should not be heavily weighted into a main financial decision.

G. The company classifies these items as non-operating expenses because all of the gains, losses, expenses, and revenues are all caused by outside parties. This outsourcing does not allow the company to have as much of a control of the item since it is not done in house. It groups all these together because it is not part of the day to day operations of the company.

H.

a. Comprehensive income for 2013 was recorded as $765,400,000. Net income for 2013 was $567,300,000.

b. The difference between these items are the sum of the dirty surplus taken out/into net income to give Molton Coors their comprehensive income. Dirty surplus is the gains and losses that are listed on the statement of shareholders' equity instead of the actual income statement.

I. Did not have to do

J.

i. The tax rate in 2013 was divided by the pretax income here is the equation 84/654.50=12.8 percent.

Case 2 Conclusion

While working case two I picked up on two major things. I feel like I finally see the importance of financial statements and how to base company projections, assumptions, and actual facts from the statements. Another thing I learned was about the excise tax. I found this interesting because I did not know that different companies would have to account for different types of tax such as a tax for distributing alcohol or selling it in certain states. I did not know that large companies that practice offshoring were given tax breaks for doing so. I completely disagree with this and find it bothersome. I decided to calculate the tax savings the company received by only having to pay 12.8 percent instead of the normal 30 percent to the government and it cost the government around 6-8 million dollars. I know this is beside the point of our case study but I feel that this is unethical because not only is this company taking jobs away by offshoring their production operations. I do not know enough about economics or accounting yet to give a better alternative or solution, but I can say that this seems a little corrupt, but that is beside the point.

I did learn a lot about how to access taxes and how each company classifies its operations based off how its items are classified such as extraordinary losses or gains on the sale of another annuity. Molten Coors had some controversial classifications, but again I feel like since they have been in operation for so long and are considered a blue chip company their operations are classified the most efficient way for them. This case furthered my knowledge on classifications and operations of large companies and helped me gain a competitive insight into auditing.

Case 3

The following lettered points outline parts A-H in the Accounts receivable subject of Pearson plc companies case study.

A. Accounts receivable is revenue that the company has earned by performing a service or by selling a good that has yet to be collected. It is sent out as a credit option with terms of payment. It is needs to have an estimation for uncollectable funds that estimation is called allowance for doubtful accounts. Accounts receivable can also be called trade receivables or just receivables.

B. The main difference between an Account receivable and a Note receivable is a Note receivable is a written promise to pay a certain sum on a certain date in the future, while the Accounts receivable is just an "oral" statement to pay off an obligation for a good or service. Notes receivables can also be long term.

C. A contra account is one that has the opposite balance of the account that is supposed to be related to. Allowance for doubtful accounts is a contra asset that deducts from Accounts receivable. The contra accounts for Pearson are "provision for bad and doubtful debts" and "provision for sales returns." Managers would typically use historical information to help with estimations for these contra accounts.

D. The percentage of sales procedure makes the estimated contra accounts balance based off of your current receivables percentage of the forecasted sales to and this information can be compared with other historical data from the past. Aging of accounts procedure follows how invoices are sorted with due dates to help with estimations of the receivables that will be uncollected. The later the invoice is the higher the risk of it being uncollectable. Managers will need historical information from past balance sheets to make sure that their estimation is within close proximity of the pasts. I believe that the percentage of sales is a better and more accurate estimation because it follows the matching concept of posting items as they occur with another by posting the revenue alongside the receivable until it is either written off or collected.

E. Extending credit is risky anyways, but can be made less risky. Extending credit to high risk of uncollectable customers is typically not something company would consider, but Pearson does this because they believe that they will at least be able to collect some of the receivables from these customers. Managers should consider all types of risk especially from problems associated with inferior merchandise, inefficiencies in filling orders, and delivery mistakes.

F. Allowance for Doubtful accounts

c 5 a 72

c 20 b 26 a BDE 72

b 3ADA 72

b AFDA 29

T/R 29

c ADA 25

d 76 Misc. 25

d ADA 76

0 A/R 76

a. The allowance for doubtful accounts had an estimation of 72 pounds at the beginning of the year; this will be posted to the balance sheet as a contra asset to A/R. It had other write offs of 26 and 3 pounds. The account has two debit postings of 5 and 20 pounds which will deduct from the normal credit balance making the account have a current balance of 76 pounds. The 76 pounds is deducted from Accounts receivable to record the loss from un-collectables which will be posted to the balance sheet to make up for the overstated Accounts receivable. The bad debts expense account will be posted to the income statement as a 72-pound deduction from Net sales as an operating expense.

G. Allowance for Sales Returns and Allowances

a 425 a Sales r/a 425

AFSRA 425

b 71 -Income stmnt.

b AFSRA 71

c 354 Sales r/a 71

-Balance sheet

c AFSRA 354

0

The entries to close the

follows

Gross Trade Receivables	
1,030	5,202
5,624	20
	443
989	

A/R 354

contra asset account

-Balance sheet

- The sales provision and allowances were estimated at 76-pounds for 2009. This estimate comes from the percent of sales approach and is rational when looking at 2008's historical data of sales returns and allowances.

H.

Trade Receivables	5,624
Sales	5,624
Cash	5,202
Trade Receivables	5,202

<u>Case 3 conclusion</u>

Case three consisted of the different types of receivables in accounting. This went well with our intermediate class because Dr. Dickinson taught it so well before we even had the class that I had no problem doing my homework before the teacher even taught chapter 7 which is the receivables chapter in our intermediate book. This case gave me an advanced knowledge of how receivables interact with another and what the different postings mean. The allowance for sales returns and allowances account was something that I had never heard of until our last class. Seeing it in Accy 420 and then Accy 303 helped me gain a competitive edge over my classmates that are not in both sections. This knowledge was furthered by doing this case study. It showed us how estimations were used whether it was based off of percent of sales method or just the historical cost method. This company had a lot to offer especially with how it practiced writing off its bad debts and accruing them. It was good hand on experience that helped in allowing me to understand how companies actually use different methods and not just seeing these methods in a book exercise or problem, but in real life examples. This case was probably my favorite just because of how closely tied it was to what I am currently learning in intermediate right now. I learned a lot about the terminology of receivables and how they move with the flow of cash and the write off of uncollectable accounts.

"On my honor I pledge that I have neither given received nor witnessed any unauthorized help on this case study."

- Thomas J. Phillips

Case 4

P7-8 On December 31, 2017, Oakbrook Inc. rendered services to Beghun Corporation at an agreed price of $102,049, accepting $40,00 down and agreeing to accept the balance in four equal installments of $20,000 receivable each December 31. An assumed interest rate of 11% is imputed.

- This problem covers the complex journal entries of the adjustments and recording of interest. It is typically best to create an amortization schedule to allow one to see the flow of money.
  - Step 1: Create a Schedule of Note Discount Amortization
    - To create the Schedule use the template I created below. To start first we need to find the carrying amount of the note upon issuance. That value is just the agreed upon price of $102,049 less the amount of the down payment which was $40,000
    - The next part of step one we need to figure out the amount of cash we received. The problem states "that we receive four equal payments of $20,000." Use this number for the cash received starting at 12/31/18 all the way through 12/31/21.
    - The next step is going to be calculating the interest after the first year. That is done by multiply the carrying amount of note at 12/31/17 by the stated interest rate of 11%.
    - Now we need to adjust our carrying amount of the note. To do this we will deduct the amount of the payment that we received of $20,000 from the carrying amount of $62,049 and then add back the interest revenue of $6,825.
    - We already know that our cash received will be $20,000 and now we need to find our new interest revenue. We will not use the original carrying amount, because we already accounted for the interest and payment earned, but since this interest is compounded we will use the $48,874 to find our new interest receivable.

- Repeat what we did for the first adjustment of carrying amount and repeat the same steps to calculate interest all the way until your note has no value left!

Date	Cash Received	Interest Revenue	Carrying Amount of Note
12/31/17	0	0	$62,049
12/31/18	$20,000	$6,825	48,874
12/31/19	20,000	5,376	34,250
12/31/20	20,000	3,767	18,017
12/31/21	20,000	1,982	0

- Step 2: Create the correct journal entries for the sale and receipts of interest for the dates listed above.
  - 12/31/17 Cash 40,000

    Note Receivable 80,000

    Discount on Note 17,951

    Service Revenue 102,049

    *the discount comes from the total sum of all the interest earned

  - 12/31/18 Cash 20,000

    Notes Receivable 20,000

    Discount on Notes Receivable 6,82

    Interest Revenue 6,825

    *we are showing that we have now earned the revenue and charging it to the discount
  - 12/31/19 Cash 20,000

    Notes Receivable 20,000

    Discount on Notes Receivable 5,376

    Interest Revenue 5,376

    *same thing here just recording what we have already done for our discounting schedule
  - 12/31/20 Cash 20,000

Notes Receivable 20,000

Discount on Notes Receivable 3,768

Interest Revenue 3,768

- 12/31/21 Cash 20,000

Notes Receivable 20,000

Discount on Notes Receivable 1,982

Interest Revenue 1,982

*now the carrying value is zero and problem is complete

- This problem taught us how to do a amortization schedule in good forma and how to make the proper entries to express the amount of interest earned with the proper amount discounted.

"On my honor I pledge that I have neither given received nor witnessed any unauthorized help on this case study."

- Thomas J. Phillips

Case 5

A. Palfinger co. would have a variety of forklifts to allow for heavy hydraulic lifting, vacuum lifting equipment to allow one to easily maneuver heavy parts throughout each stage of production. The company would have an assembly line with lots of hydraulic drills and welding machines. Palfinger would own shipping trucks and flatbeds, and also a large warehouse for the construction of the cranes and other assets.

B. The €149,990 represents all of the Property, Plant, and Equipment that the company currently has on hand that is used in the production to create the finished product to allow for revenue generation upon a sale.

C. Palfinger records all land, buildings, undeveloped property, plants and machinery, all forms of equipment including fixtures and fittings, assets under construction, and any form of prepayment that will be deducted at a later date.

D. The prepaid expense would be the construction in process while the asset is currently under construction. Depreciation does not start until the asset is available for use and that does not occur until the asset is finished. The reclassification comes from Palfinger finishing the construction of an asset and the costs being taken out and debited to equipment to show the construction of the asset is complete.

E. Palfinger depreciates all of its property and equipment using the straight-line depreciation method. The policy seems reasonable for its idle assets such as buildings, and land, but for the equipment it is hard to estimate and accurate value using straight-line because of the variable uses of the equipment. The tradeoffs management makes deals with having to decide on the cheapest and most efficient option versus the most accurate.

F. Palfinger capitalizes the expenditures and uses the new value net of capitilization to depreciate the assets over the new life that the improvement gave it. The alternative method is to charge the improvements to the current years expense account. The best for Palfinger would be to keep what the method they are using because they already have a system in place and I believe it is the best method because it keeps the depreciation up to date by taking it from the newest book value of the asset.

G. "Use the information in the financial statement notes to analyze the activity in the "Property, plant and equipment" and "Accumulated depreciation and impairment" accounts for 2007. Determine the following amounts"

i. The €61,578 comes from the additions and the additional capitalization.

ii. The €733 deduction for government grants comes from Palfinger complying with a government ordinance or constructing something that the government needed authorized and Palfinger deducted these grants from the assets carrying value.

iii. The €12,557 comes from the total of all assets in use being depreciated using the straight-line method.

iv. The net book value of the plants, property, and equipment that Palfinger disposed of was €1,501

H. The gain on the sale of property, plant, and equipment is a gain of €154.

I. Straight-Line and Double-declining balance

SL: 10,673	8,793	6,913	5,033	3,153	1,273
DD: 10,673	6,403	3,841.48	2,304.88	1,382.92	1,273.06

J. "Assume that the equipment from part *i*. was sold on the first day of fiscal 2008 for proceeds of €7,500. Assume that Palfinger's accounting policy is to take no depreciation in the year of sale."

i. The gain or loss comes from a reduction of the book value of the equipment and the proceeds from the sale. The transaction results in a loss of €293,000. The loss and depreciation expense would both effect Palfinger's income statement since the €1,880,000 of depreciation were reported.

ii. The gain or loss comes from a reduction of the book value of the equipment and the proceeds from the sale. The transaction results in a gain of €1,096,200. The loss and depreciation expense would both effect Palfinger's income statement since the €4,269,200 of depreciation were reported.

iii. The income statement effect of the straight-line depreciation method of the two years is a decrease of €2,173,000. The double-declining balance method has a two year decrease of €3,173,000. This allows for comparison the two methods to show the cash flow difference between the two methods.

"On my honor, I pledge that I have neither given received nor witnessed any unauthorized help on this case study."

- Thomas J. Phillips

Case 6

A. The 2009 income statement shows research and development expenses of SEK 13,193 (millions of Swedish Krona). What types of costs are likely included in these amounts?

i. Research and development would be an operating expense. These costs are typically variable unless it is a fixed amount of money that will be used to make research successful.

B. Volvo Group follows IAS 38—*Intangible Assets*, to account for its research and development expenditures (see IAS 38 excerpts at the end of this case). As such, the company capitalizes certain R&D costs and expenses others. What factors does Volvo Group consider as it decides which R&D costs to capitalize and which to expense?

i. Volvo currently only capitalizes Research and Development costs only during a industrialization phase of the actual product development. Any other expenses incurred for that are to be charged as an expense on the income statement. The factors consist of whether the asset is actually in the development stage or not.

C. The R&D costs that Volvo Group capitalizes each period (labeled Product and software development costs) are amortized in subsequent periods, similar to other capital assets such as property and equipment. Notes to Volvo's financial statements disclose that capitalized product and software development costs are amortized over three to eight years. What factors would the company consider in determining the amortization period for particular costs?

i. It is based off of a straight-line depreciation method of the actual acquisition value of the assets. This value can be adjusted by write-downs, and a historical estimation of useful lives. The company usually amortizes the expense over 3-8 years based off of the above information.

D. Under U.S. GAAP, companies must expense all R&D costs. In your opinion, which accounting principle (IFRS or U.S. GAAP) provides financial statements that better reflect costs and benefits of periodic R&D spending?

i. U.S. GAAP expensing all research and development costs underestimates net income for the period that it has to be expensed in. IFRS allows the expenses to be amoritized along with the useful life of the asset that was in the development phase which makes sense because it evenly disperses the expenses to each period of the useful life. IFRS gives a more accurate representation of cost and benefits because it does not expense all of the R&D costs at once.

E. Refer to footnote 14 where Volvo reports an intangible asset for "Product and software development." Assume that the product and software development costs reported in footnote 14 are the only R&D costs that Volvo capitalizes.

i. What is the amount of the capitalized product and software development costs, net of accumulated amortization at the end of fiscal 2009? Which line item on Volvo Group's balance sheet reports this intangible asset?

i. The total amount that is capitalized is SEK 11,400.

ii. *Create a T-account for the intangible asset "Product and software development," net of accumulated amortization. Enter the opening and ending balances for fiscal 2009. Show entries in the T-account that record the 2009 capitalization (capital expenditures) and amortization. To simplify the analysis, group all other account activity during the year and report the net impact as one entry in the T-account.*

i.

F. Refer to Volvo's balance sheet, footnotes, and the eleven-year summary. Assume that the product and software development costs reported in footnote 14 are the only R&D costs that Volvo capitalizes.

Product and Software Development (in millions)

12,381	
2602	2830
	448
<u>**11400**</u>	

i.

	2007	2008	2009
Product and Development Costs capitalized	<u>$2,057</u>	<u>$2,150</u>	<u>$2,602</u>
Total R&D costs expensed	<u>$11,059</u>	<u>$14,348</u>	<u>$13,139</u>
Amortization of all previously capitalized expenditures	<u>$2,357</u>	<u>$2,864</u>	<u>$2,830</u>
Total R&D costs during the year	<u>$10,759</u>	<u>$13,634</u>	<u>$12,911</u>

ii. Provide the journal entry that Volvo Group prepared to record 1) total 2009 R&D costs incurred during the year and 2) the amortization of previously *capitalized product and software development costs. Consider your answer to part a, above to determine which accounts are affected. (Hint: you will not be able to allocate specific amounts for each of the accounts you credit, but you should be able to identify the accounts that are likely to be credited.)*

1. *R&D 13,139*

Expenses 13,139

2. *Intangible Assets xx*

R&D xx

(In millions)	2007	2008	2009
Net sales	276,795	294,932	208,487
Total Assets	321,647	372,419	332,265

iii. *What proportion of Total R&D costs incurred did Volvo Group capitalize (as product and software development intangible asset) in each of the three years?*

i. In 2007 19.12% was capitalized and in 2008 it was 15.77% and 2009 was the largest with 20.2% being capitalized.

G. Assume that you work as a financial analyst for Volvo Group and would like to compare Volvo's research and development expenditures to a U.S. competitor, Navistar International Corporation. Navistar follows U.S. GAAP that requires that all research and development costs be expensed in the year they are incurred. You gather the following information for Navistar for fiscal year end October 31, 2007 through 2009.

ii.

(% of R&D to Sales)	**2007**	**2008**	**2009**
Volvo	3.9	4.7	6.0
Navistar	3.1	2.7	3.8

For my case 7, I was absent in class and Dr. Dickinson had me write this.

Thomas Phillips

Mrs. Dickinson

Tax Paper

Taxodus

I find this interesting how the movement of profits can be traced from country to country. The way apple pioneers their profits to get most of the money is almost mind blowing to me. I had no idea that it was legal and possible. It makes sense to me though and honestly is capitalism at its finest by making the most of all of the tax rates out there. The amount of money routed through the Netherlands through subsidiaries owned by companies like Walmart is 20 times the counties GDP. That is a huge number. There is obviously a lot of evasion going on with the transfers of money especially since a lot of large companies are doing this.

This video introduced billionaires row. It is basically its own world of just billionaires. They do not have any dealing with the money or anything like that. They do not pay taxes on it because the money is always moved around. They avoid media talk and are like ghosts but have a credit card. This is mind boggling to me because it just shows how much goes into the evasion of taxes. The tax revenue missed is around 1 trillion dollars. That is just downright sickening to me that this is all possible in today's world. I do not understand why these people do not want to pay taxes to their country and watch their tax dollars go to work in public funds and organizations that will help better the country as a whole. These people are selfish and are just finessing the system to pay as little taxes as possible.

The tax industry hides what is going on in the tax havens and evasions. The accounting firms help do this and is not possible without them. To me it is ethical to for the firms to do this because these companies are clients and the firms job is to do what is best for their client. The special arrangement to transfer profit from UK to Netherlands allows for a much lower amount of taxes to be paid. It is highly controversial that this is going on, but technically it is legal. There are two faces to an organization the consumer face, and then the underground side. These companies use trickery to get what they want. This trickery is in the form of tax evasion to move businesses profits and money around to pay the lowest of taxes possible. Tax avoidance is legal, because they are working within the gaps of the law, but it does not answer the question of ethics. It is ethical to some and unethical to most. A large company should have to pay taxes where the revenue is earned. Back to the Walmart example they have these tiny companies that do not generate revenue on their own, but yet have billions of dollars flowing through them. It is the principal of lying and dishonesty it is completely misleading. The financial sector should have to be honest and held accountable for what they do.

The accountants are so heavily involved in the rules and regulation of accounting and financials, that they are basically regulating themselves, with ex partners being on the committees and such. They will obviously not do anything illegal, but they definitely know how to bend the rules to their favor and help their past firm out even more. Everyone has gotten used to the benefits of these huge companies, and just do not know about all this tax evasion and that overall it hurts the individual consumer more than it helps them. It all goes back to being greedy and being held accountable to a standard of ethics.

Case 8

In this case I enjoyed it because my Dad works for Glaxo Smith Kline. Even though we did not do part B, it was still cool to be able to see all of their information and talk to my about it. The information we covered was on our first test in intermediate so I felt like I knew how to do it. I enjoyed being able to dissect this case and understand how the cash moves and the purpose of the treasury stock.

A Consider Merck's common shares.

I. How many common shares is Merck authorized to issue?

- Merck is authorized 5,400,000,000 shares of common stock.

How many common shares has Merck actually issued at December 31, 2007?

- Merck has issued 2,983,508,675 shares

II. Reconcile the number of shares issued at December 31, 2007, to the dollar value of common stock reported on the balance sheet.

- The par value is 1 cent per share.

III. How many common shares are held in treasury at December 31, 2007?

- 811,005,791 shares of treasury stock are held at year end.

IV. How many common shares are outstanding at December 31, 2007?

- 2,172,502,884 shares outstanding after year end of 2007

V. At December 31, 2007, Merck's stock price closed at $57.61 per share. Calculate the total market capitalization of Merck on that day.

- $125,157,891,100 is the total market capitalization for the shares at year end.

C Why do companies pay dividends on their common or ordinary shares? What normally happens to a company's share price when dividends are paid?

- Companies pay dividends to share profits proportionately with all shareholders (owners) of a company. Dividends affect the share price negatively by exactly how much in dividends were paid. A company that has no dividends will likely have its value reduced just by the market itself since they must not be earning enough profits to send out dividends.

D. In general, why do companies repurchase their own shares?

- Companies will buy their shares back to reinvest capitol into the company, and also to help in reducing the amount of shares outstanding. This method can also be used to stop the dilution of ownership and other owners shares that are already outstanding.

E. Consider Merck's statement of cash flow and statement of retained earnings. Prepare a single journal entry that summarizes Merck's common dividend activity for 2007.

- Retained Earnings 3,310,700,000

Dividends Payable 3,400,000

Cash 3,307,300,000

G. During 2007, Merck repurchased a number of its own common shares on the open market.

I. Describe the method Merck uses to account for its treasury stock transactions.

- Merck uses the cost method when it accounts for treasury stock transactions. They use this method because it is the method required by GAAP.

II. Refer to note 11 to Merck's financial statements. How many shares did Merck repurchase on the open market during 2007?

- Its repurchased 26,500,000 million shares during 2007.

III. How much did Merck pay, in total and per share, on average, to buy back its stock during 2007? What type of cash flow does this represent?

- It payed 1,429,700,000 billion dollars to repurchase the stock. It payed 53.95 dollars per share and it represented a cash outflow.

IV. Why doesn't Merck disclose its treasury stock as an asset?

- Because treasury stock is not an asset since it can not have equity in its self. It is a reduction to equity and diminishes the total amount of shares that the company has outstanding.

I

In Millions	2007	2206
Dividends	$ 3,307.3	$3,322.6
Outstanding Shares	2,172,502,884	2,167,785,445
NI	$3,275.4	$4,433.8

Operating CF	$6,999.2	$6,765.2
YE- Stock price	$57.61	$41.94
Dividends per share	$1.52	$1.53
Yield	2.65%	3.65%
Payout	101%	75%
Dividends to TA	6.84%	7.45%
Dividends to CF	47.25%	49.11%
TA	$48,350.7	$44,569.8

"On my honor I have not received any unauthorized help on this work."

- Thomas Phillips

Case 9

This case was a little behind our intermediate class. I like that a lot better, not only because I understand the terminology a lot more but also because it helps to further my knowledge and see how an accounting practice that I have been exposed to is transitioned into the real world. Just because I already knew how to do this part of accounting does not mean I did not gain valuable knowledge from the case. It allowed me to further grasp the true definitions and account movements on a real company. That is what was so cool to me.

A. Consider trading securities. Note that financial institutions such as State Street typically call these securities "Trading account assets."

iIn general, what are trading securities?

- Trading securities are short term assets and that are held with the intention to sell and terminate current ownership within a fiscal year.

iiHow would a company record $1 of dividends or interest received from trading securities?

- Interest Receivable xx

Debt Investments xx

Interest Revenue xx

iiiIf the market value of trading securities increased by $1 during the reporting period, what journal entry would the company record?

- Fair Value Adjustment xx

Unrealized holding Gain xx

B. Consider Securities available-for-sale. Note that State Street calls these, "Investment Securities available for sale."

i In general, what are securities available-for-sale?

- Is any type of investment/asset that is not classified as a held to maturity or trading securities.

ii How would a company record $1 of dividends or interest received from securities available-for-sale?

- Cash xx
  Dividend Revenue xx

iii If the market value of securities available-for-sale increased by $1 during the reporting period, what journal entry would the company record?

- Fair Value Adjustment xx
  Unrealized Holding Gain xx

C. Consider securities held-to-maturity. Note that State Street calls these, "Investment securities held to maturity."

i In general, what are these securities? Why are equity securities never classified as held-to-maturity?

- These securities are investments that have no intention to sell or change ownership until the date of maturity. Equity securities are not classified as held-to-maturity, because there is no way to put a maturity date on the expiration of shares owned in another company.

ii If the market value of securities held-to-maturity increased by $1 during the reporting period, what journal entry would the company record?

- No journal entry would be recorded for a fair value adjustment until the security is sold. Then a gain or loss would be recognized in net income instead a fair value adjustment.

D. Consider the "Trading account assets" on State Street's balance sheet.

i What is the balance in this account on December 31, 2012?

- $637,000,000

What is the market value of these securities on that date?

- $637,000,000

iiAssume that the 2012 unadjusted trial balance for trading account assets was $552 million. What adjusting journal entry would State Street make to adjust this account to market value? Ignore any income tax effects for this part.

- Fair Value Adj. 85,000

Unrealized Holding G/L- Income 85,000

E. Consider the balance sheet account "Investment securities held to maturity" and the related disclosures in Note 4.

i$11,379,000,000

ii$11,661,000,000

iiiThe amortized cost is $11,379,000,000. The amortized cost represents the price of the security plus or minus any discount or premium that was received upon recognition of the security. It compares to the original cost as the same because there was no discount or premium involved in the acquisition of the security.

ivIt most likely means that the interest rates have changed since the security was originally acquired. The interest rates would have decreased since there is a fair value gain in the security.

F. Consider the balance sheet account "Investment securities available for sale" and the related disclosures in Note 4.

i$109,682,000,000

iiThe net unrealized holding gain is 590. This came from the prior balance of the unrealized holding g/l account having a debit balance of 1004. That is then decreased in 2012 to 414. The difference is a gain in 2012 of 590.

iiiThe gain is 55 million that increases net income by the same amount but is decreased in the statement of cash flows section.

G. State Street's statement of cash flow for 2012 (not included) shows the following line items in the "Investing Activities" section relating to available-for-sale securities (in millions):

iInvestment in AFS 60,812

Cash 60,812

iiCash 5,399

UHG 67

Realized Gain on AFS 5,411

Investment in AFS 55

iiiThe investment balance is at 5,411.

"I have not given nor received an unauthorized help on this case."

- Thomas Phillips

Case 10

In this case our class was divided into groups and each group was given a different software program. My groups program was Google Fusion. I had never heard of it before, but I did some in depth research on it and found a lot of practical accounting uses. I am honestly surprised that it is not implemented today on a wide spread basis. There was a lot to learn and it definitely spurred on interest for me.

1. Google Fusion was launched 9 years ago. It allows users to visualize the data that is uploaded onto the database. It helps users gain a business insight with charts and graphs. Users can edit data from different locations with other users in real time just like Google docs. Google Fusion uses cloud service to allow users to send their data online. The only resource needed to use it is a Gmail account and lots of data, because it runs within Google docs.
2. To understand how to use Google Fusion one needs to first understand these common forms of data visualization pie charts, bar charts, line-plots, scatterplots, timelines, and geographical maps. To get started one will also need data. To get this data it would most likely just come from sales, purchase orders, or customer databases. It needs to be in Keyhole Markup Data which is the common form of XML language. To gain insight into a business from Fusion such as what city is the most profitable or what state has the most

sales one would just simply upload the sales data and convert it to a geographic map. All that is needed is location of the sale and a product price of the item which should all already be in the data. That is just one example. This could be used for most business inquiries that are not easy to see.

3. How to use Google Fusion with Audit, Tax, and Financial statement analysis
    a. Audit
        i. It would allow auditors to gather historical data from past audits and compare them with timelines and geographic locations to figure out what is missing and what adds up. It would give auditors the historical information that would be needed and save them time by putting the data into a simpler form.
        ii. It could use the tables to create queries to figure out what product or decisions makes the company more profitable.
        iii. An auditor can use this function to run trial and error on prospective ideas and data to make sure that everything checks out and to find any mistakes by running multiple different tables with the same data to make sure that it adds up with the other tables and nothing is being exaggerated or misleading.
    b. Tax Planning
        i. Google fusion could be used for tax planning by uploading all of the past tax financial data to the current one to compare how new tax laws or codes have affected income and income tax.
        ii. It also could be used to forecast any tax discounts based off of historical data. The data could give an estimate of any discounts or unexpected breaks that a company would expect in a financial period.
        iii. The data could be used to show the benefits of moving to different geographic location and making sales in different geographic location based off of the States income and sales tax.
    c. Financial Statement Analysis, Valuation, and Advisory

i. Google Fusion could be used to plug in numbers to see how it affects the financial statements to get a better understanding on what needs to happen in the future to maximize potential.

ii. Fusion would give a good platform for Financial statement valuation, because it would allow companies to input all financial information into the cloud. Next it would organize the data and sort it. The company can then choose to view it in charts and graphs or whatever valuation tool is best for them to understand. After it is being created it will streamline the valuation process and allow the user to better understand the data.

iii. This system could be used to give advisory info quickly because it simplifies the data and would barely even use the advisors time. The simplified data would give the advisor enough information to make an education decision on what needs to be done to achieve the users goal.

4. Dear Partner,

Hope this email finds you well. As you know our firm is the leader in technological accounting. With means of automation and data analytics, I think our next investment should be into a software that stores large amounts of data and can place it into charts, graphs, and maps that are easy to analyze. There is an obvious tradeoff here. The cost will be outweighed by the amount of time saved on work hours. Our employees would be more efficient because they will not have to manually look for patterns or search for what they need in the data. They will now be able to literally just look at a simple chart that has been engineered to their liking to show exactly what they are looking for.

No other firms are implementing this software currently. I believe it to be revolutionary. The amount of savings is just absolutely ridiculous. It will also make our employees lives easier because the data will be simplified and easy to understand. The simplification still can cover complex circumstances. To me this purchase is a no brainer and I would love to have you on my side.

Thank you,

Thomas Phillips

Case 11

Summary:

This case was hands on. I was shown how the different forms of income taxes, the tax rates, and the permanent differences that have been discussed in my intermediate courses where actually executed into the financials of a company. The main knowledge I have gained from this was a better way to understand these accounting terms and connect them to real world situations. Looking into ASC 740 gave me an insight into how the practices and principles were originally written and not just being taught it from a third party. I enjoyed this because it exposed me to the raw information and allowed for pure interpretation on my part. To me this was harder than the average case, but the hard work pays off from the experience gained.

A. Describe what is meant by the term book income? Which number in ZAGG's statement of operation captures this notion for fiscal 2012? Describe how a company's book income differs from its taxable income.

i Book income is the income reported within the financial statements. It is determined on an accrual basis following the Generally accepted accounting principles. Book income is basically just pre-tax financial income. Zaggs book income for 2012 is 23,898,000. The main difference between Taxable income and Book income is how the two are determined. Book income as already discussed is determined on an accrual basis, while tax income is on a cash basis.

B. In your own words, define the following terms:

i A permanent difference cannot be reversed, and it is the difference between book income and taxable income. An example is any fine or regulation that sets the company back, but it cannot have a tax effect on it.

ii A temporary tax difference can be reversed, and it is also that difference between book income and taxable income. An example would be any form of unearned revenues such as receiving the payment, but not performing the service obligation. Over time the cash will be recognized in the correct period.

iii Statutory tax rate is the legally imposed rate. Multiple statutory rates can be implied to items such as income.

iv Effective tax rate is the average rate for that of which a company pays taxes on. This is based off the tax rate for pre-tax profits.

C. Explain in general terms why a company reports deferred income taxes as part of their total income tax expense. Why don't companies simply report their current tax bill as their income tax expense?

i The reporting of deferred income taxes as part of the total income tax expense is necessary to upholding the integrity to the users of a firm's financial data. If this were not included in the computation of income tax expense it would greatly diminish the users understanding by completely throwing out the future taxable entities that have arisen from the transactions. It needs to be in that computation to allow users to see that there has been a transaction that has created an asset and thus also a liability depending on the type of transaction. This can be found in ASC 740-370-30-1. Since the income tax expense is treated like ordinary expenses ASC 740 aligns with the expense recognition principle. The expenses should be recognized in the same period as the revenue is incurred. The deferred tax asset and deferred tax liability follow that guideline. The Asset is created once a transaction has happened and the tax has been paid. The revenue is not recognized until the performance obligation has been satisfied and that is why the current expense turned to an asset. The liability aligns itself with that principle as well by following the same standard except transaction is larger in the future the tax expense must be recognized then. The main point of the computation methods is upholding the same consistency so that all users can grasp an accurate depict of what they are looking at. This also allows for industry wide comparison as well.

D. Explain what deferred income tax assets and deferred income tax liabilities represent. Give an example of a situation that would give rise to each of these items on the balance sheet.

i A deferred tax asset is the tax result that is attributable to deductible temporary differences. It represents the increase in taxes saved or that can be refundable in future years. It is all arise from the deductible temporary differences at the end of the current year. It can be shown as income taxes paid are less than income taxes payable. It can be created through unearned revenue. The reason this asset is created is because the company already pays taxes on the cash received in the current year and does not have to pay tax on it again when it is actually recognized. That is how the account is increased.

A deferred tax liability is the increase in taxes payable in future years as a result of temporary differences that are present at year end of the year. The company can use the liability as an advantage for current years, by not having to pay the tax outstanding until future years. These deferred tax liabilities can be created from a change in deprecation methods such as instead of equal deprecation the company can change methods to have future depreciation decrease resulting in more taxes to be paid later on than in the current year.

E. Explain what a deferred income tax valuation allowance is and when it should be recorded.

iThe deferred income tax valuation allowance account is needed when the future income generated is no longer plausible to cover the deferred tax asset. The account is used to reduce the deferred tax assets balance to a balance that the future income will more than likely be able to cover it. This process is executed by debiting income tax expense account to show where the money will go, and then crediting the allowance account to reduce the asset when it is closed.

F. Consider the information disclosed in Note 8 – Income Taxes to answer the following questions:

iIncome Tax Expense 9,393
Deferred Tax Asset 8,293
Income Tax Payable 17,686
iiIncome Tax Expense 9,393
Deferred Tax Asset 8,002
Deferred Tax Liability 291
Income Tax Payable 17,686

iiiThe effective tax rate for ZAGG during 2012 was 39.30%. The difference between the effective and statutory comes mainly from the State imposed tax rates and any other form of sales or shipping taxes that is levied onto the corporation.

ivIt is the sum of the current deferred tax assets and the non-current deferred tax assets. (6,192,000 + 6,596,000)

"On my honor I have neither given nor received an unauthorized help on this work."

- Thomas Phillips

Case 12

Summary:

I enjoy the cases where we are required to do active research on a subject. Researching ASC 606 gave me insight into changing accounting principles in the real world. Our intermediate book cannot teach us stuff like that which is why I enjoy it so much. The hands-on experience gives a competitive edge to the students in our class because this is stuff that we are going to be having to actively doing in our jobs. I did some further research into the required accounting change and noticed that all of the big four firms had done an article on ASC 606. This was cool to see because it shows just how important some of the things in this class are that we are learning.

A. In your own words, define "revenues." Explain how revenues are different from "gains."
    i. Revenues are what is earned from providing services or merchandise to the customer. Revenues are generated from transactions with customers. The difference between gains and revenues is that gains have no deductions except for tax while revenues are deducted from expenses. Gains typically do not reoccur periodically throughout business transactions, but Revenues can be estimated year to year fairly accurately because they are almost always fairly consistent.

B. Describe what it means for a business to "recognize" revenues. What specific accounts and financial statements are affected by the process of revenue recognition? Describe the revenue recognition criteria outline in the FASB's Statement of Concepts No. 5.
    i. In the new guidelines set forth by ASC 606 revenue is recognized when the performance obligation is satisfied by the controlling entity and ownership of the goods has transferred. Recognizing revenue means that the company will be showing that they have created a business transaction and contract that has been completed in that reporting period. This recognized revenue will be a major part of Net Income for that reporting period. The accounts receivable

account can be increased in this transaction if the company is opening up a credit line. Account receivable account diminishes once the customer pays. The revenue will only be recognized based on collectability of the customer. Other accounts vary depending on what type of industry the entity is in. Inventory would be decreased, and cost of goods sold would be increased at the point of sale, but Cost of goods sold would go to diminish the revenue because the expenses must follow the revenues. Same with depreciation and any other operating expenses. They will be deducted from and accounted for based on whatever amount of revenue was recognized. The main financial statement impacted by Revenue is the Income Statement. Another financial statement would be the Balance sheet because once the revenue is recognized is put on the income statement and all the expenses associated with it follow behind it.

C. Refer to the Revenue Recognition discussion in Note 1. In general, when does Apple recognize revenue? Explain Apple's four revenue recognition criteria. Do they appear to be aligned with the revenue recognition criteria you described in part b, above?

   i. Apple recognizes revenues aligned with ASC 606 because it recognizes the revenue once the evidence of an arrangement exists, delivery has occurred, the sales price is determinable, and collection is probable. All four of their criteria must be filled for the company to recognize the revenue in that period. This follows ASC with collectability, arisen contract, and transfer of ownership. Apple recognizes revenues differently for different product lines. Gift cards are not recognized they are deferred until they are used, but the software and their upgrades are reported normally.

D. What are multiple-element contracts and why do they pose revenue recognition problems for companies?

   i. Multiple element contracts arise from products that do not have standalone prices or are sold in bundles. The main problem is created from companies entering into contracts with multiple customers and most of the contracts having similar value. They are comprised of different elements that are individually priced by product type and bundled. The amount cannot be recognized as the same for all contracts, so that is where the new principle comes in and tries to clear that shadiness over the true and correct value of the contract that is to be reported.

E. In general, what incentives do managers have to make self-serving revenue recognition choices?

    i. A lot more goes into revenue recognition than just putting a sales figure number on the Income Statement. The manager wants what is best the company and is going to recognize the total amount of revenue that would most economically benefit the company with the amount of expenses that will have to follow that revenue. Other factors can come from collectability during that reporting period, product defects that will have to be returned, and warranty expenses. The main incentive for managers is to manipulate the revenue in the way in which it will align within the requirements for whatever incentives the company has offered the manager to reach a certain amount revenue each period.

F. Refer to Apple's revenue recognition footnote. In particular, when does the company recognize revenue for the following types of sales?

    i. Apple technically does not own the actual songs listed on iTunes, but instead gets its revenue from commissions that are created through the customer purchasing the song on their application.

    ii. Apple for in-store recognizes the sale immediately because as ASC 606 stated the contract was made, the transfer has occurred, and collectability is also reasonable. As for the online sells it differs. The transfer of ownership is variable for each online order, so the company does not recognize it until the product has been delivered assuming all other criteria has been filled.

    iii. It is recognized the same way as if an online sale. Apple will not recognize revenue until the goods are delivered to the seller, because Apple has a FOB Destination shipping type and aligns itself within ASC 606 standards.

"On my honor I have neither given nor received any unauthorized help on this case."

- Thomas Phillips